DOW THEORY LETTERS INC.

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36 Letters per Year – $75 Annually

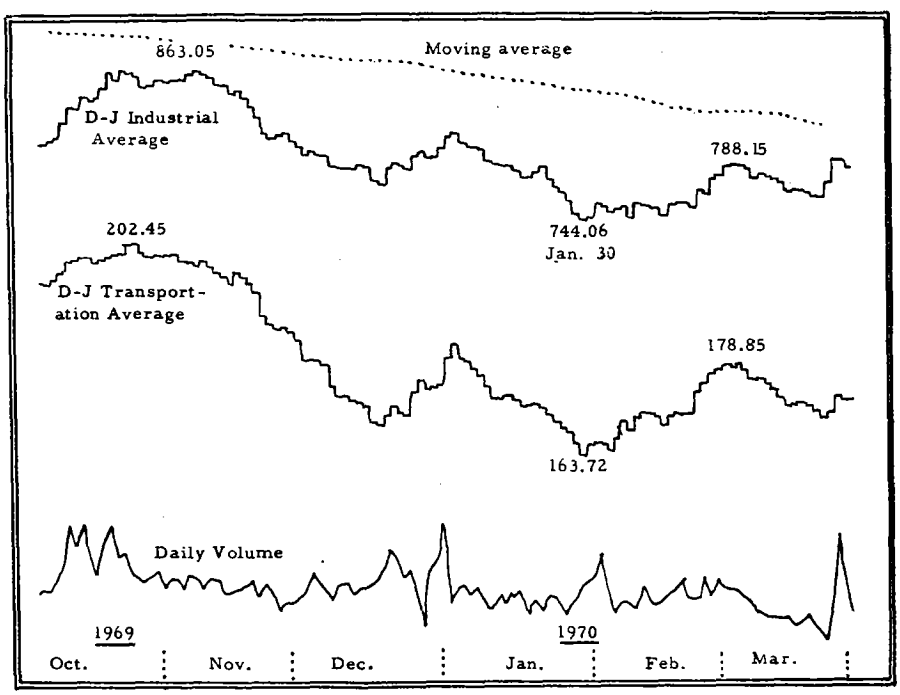
Registered with the Securities Exchange Commission

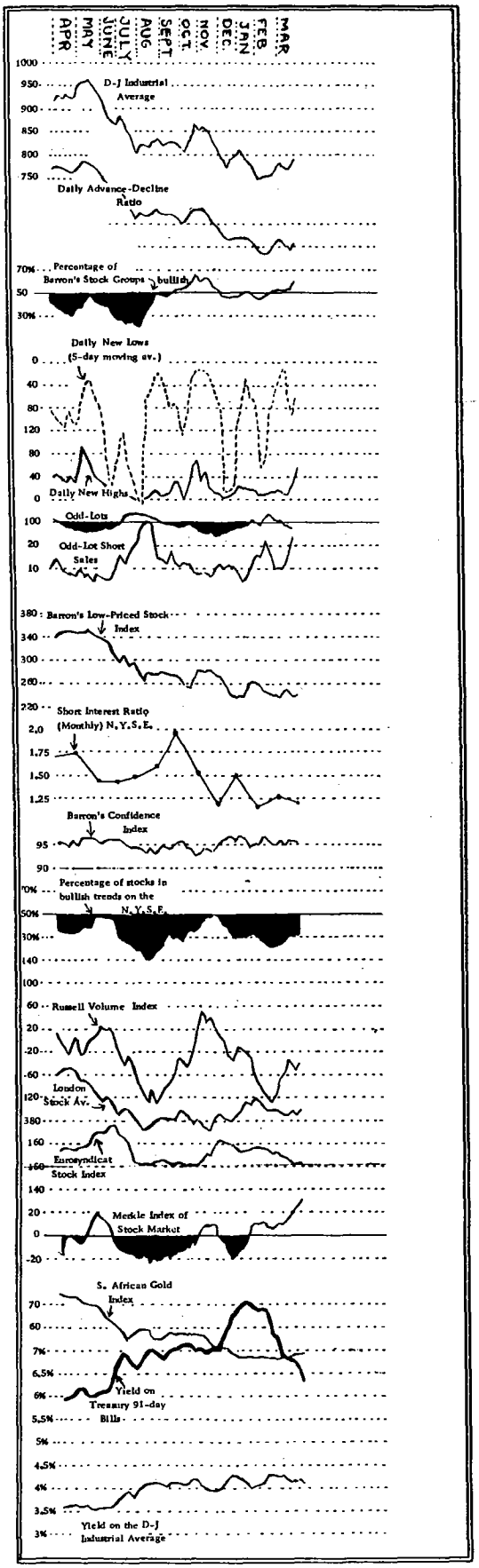
April 1, 1970 Letter 457

THE MARKET: "Aiken's Law" states that no matter how the battle looks, one handles the situation by simply announcing "victory" and heading for the hills. If the law were applied to Vietnam, we would expect to see President Nixon declare that "the U.S. has won the war," and that we are therefore bringing all our troops home immediately.

Last week, Aiken's Law was applied to the economy. Remember, only a month ago the Administration wanted to postpone a 5.7% pay increase for Federal employees in order to hold back inflation. But last week fears of recession proved too much for the same Administration. Despite a February rise of .5% in the Consumer Price Index (or an annual rise of 6%), the Administration turned to jazzing up the economy. President Nixon "unfroze" $1.5 billion of housing money which had been held up as an anti-inflation measure. Fed Chairman Arthur Burns announced that the Reserve Board was putting more money into circulation, expanding the money supply for the first time since last summer. And in a glowing example of Aiken's Law, House Minority Leader Gerald Ford emerged from a conference with the President and stated, "The problems of inflation are defeated."

Wall Street celebrated the event, with the Dow rocketing 25 inter-day points on March 25, later holding 16.37 of those points at the close. Volume surged to 17.5 million shares. Far from being heartened by the move, the writer noted that in three trading days (March 23, 24, 25) the Industrial Average rose from its March low of 763.60 to a point just above the February peak of 788.17. This immediately sets up a technical problem of non-confirmation. As stated in the last Letter, in order for the current move to flower into a true secondary (upward) correction, the Industrial Average will have to better its 788.15 February peak



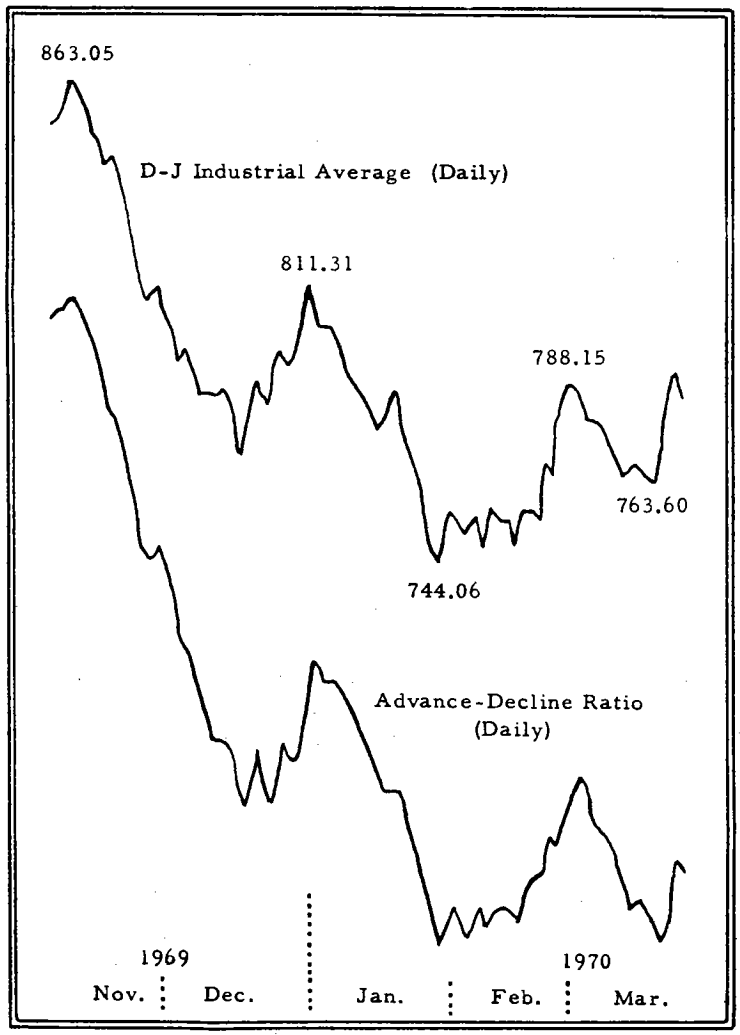


and the Transportation Average will have to better its 178.85 peak (see chart on page 1). So far, Transportation has failed to confirm.

Even more dramatic, from the non-confirmation standpoint, is the chart showing the daily progress of the Dow and the advance-decline ratio. The greater weakness of the great mass of issues (compared with the Dow) is immediately apparent. On the decline to the March low, the A-D ratio halted within the bearest fraction of its January bear market low. During the same decline the Dow halted at 763.60, 20 points above the January low. Then the three-day surge took the Dow to a new recovery high since January. The A-D ratio failed by a wide margin to confirm.

This sets up a technical problem which is clear enough. Either (1) the A-D ratio will confirm by bettering its own early March peak or (2) the odds favor Industrials and the rest of the market returning to re-test and probably penetrate the March lows.

As far as I am concerned, the whole movement since the January 30 low is one more complicated counter-primary movement which is calculated to suck the perpetual optimists into the great bear trap. Since the bear market started in February, 1966, we have seen instance after instance of upward corrective action. Each time the soothsayers have claimed that the "bear market is over," and each time the market has ultimately smashed to new lows. I can only say that regardless of whether this correction ends in a week or in a matter of months, new lows will again be seen and additional severe losses will be suffered by those who turned bullish before the primary bear forces exhausted themselves.



So far during the first and current second phase of this primary bear market, the losses in individual stocks and individual stock groups have been highly selective. This selectivity will probably continue throughout the second phase. During the third or final phase of the bear market I expect the selectivity to all but disappear. During the third phase I would expect everything to more or less "even out" on the downside, with the current holdouts dropping precipitously, thereby catching up with the worst performers of today. This is roughly the reverse of that which occurs during the third (explosive) phase of a bull market.

A broker friend from Paine, Webber, Jackson and Curtis sent me this tabulation of 19 leading stock groups as tabulated from Standard & Poors. The tabulation shows that damage to stock groups has been much worse so far than the drop in the Averages suggests. In fact, only five of these groups have put in a better performance than the leading industrial averages. The tabulations list the high price for each group, the year the high was recorded, the price as of February 11, 1970, and the decline in percentages since the highs. Note that a third of the groups have declined roughly 50% or more since their highs were established.

Group	High	Year	Price 2/11/70	% Decline
Aerospace	125.0	1967	42.5	66
Air Transport	145.4	1966	55.4	62
Aluminum	179.0	1956	92.2	48
Autos	138.5	1965	81.3	41
Bldg. Materials	77.8	1968	58.2	25
Chemicals	76.8	1965	38.3	50
Drugs	165.0	1969	160.5	3
Elec. & Electr.	121.5	1967	80.3	34
Electronics	669.2	1967	535.6	20
Foods	75.9	1968	66.6	12
Machinery	118.5	1969	92.6	22
Office & B.E.	1377.4	1970	1287.6	7
Oil	161.4	1969	92.9	42
Paper	227.1	1969	183.5	19
Radio-TV	401.7	1966	177.7	56
Retail Stores	107.2	1969	96.1	10
Steel	99.9	1959	44.5	55
Textiles	97.2	1965	64.4	34
Tires	285.1	1969	210.8	26

As I re-read the above I realize how much I dislike writing about the bear market. It is a thankless task warning people against their own emotions. If a man is interested in the stock market, he is almost always interested in buying stocks. My job until this bear market is over is to attempt to use my knowledge and logic against the vast amount of emotional bullishness

which I know will break the bulls in the end. Those of us who have the fortitude and stamina to stay out of the bear market will ultimately have the capital necessary to purchase the great bargains which are sure to appear when the final phase of the bear market is over. It could be a wait of a year or so, but impatience and egotism will only mean frightful losses between here and the time the bear market ends.

ANNUAL BREADTH: Following is an interesting table which I have set up for the years 1963 through 1969. Also included for comparison purposes is the year 1929. I wanted to compare various years in terms of total breadth. The results were surprising to me.

	1929	1963	1964	1965	1966	1967	1968	1969
Advances	135	1007	1002	904	252	1113	1004	169
Declines	849	416	395	519	1185	386	421	1357
Total issues traded	1269	1580	1623	1640	1664	1713	1784	1791
A-D ratio	-5.7	+3.7	+4.0	+4.0	-5.6	+4.2	+3.2	-6.6

The A-D ratio figures (bottom row) show the annual advance-decline tabulations as if they were the action of a single day. For instance, for the year 1929 there was a pleurality of 714 declines (849 minus 135). Dividing 714 by 1269 (total issues traded) gives us a ratio figure of minus 5.7 or the amount the A-D ratio suffered on the downside. Since the A-D ratio shows the direction and relative intensity of advance or decline among the majority of issues, we can therefore compare each of these years as to total breadth.

The first thing that surprised me was that the year 1966 was almost as bad from a breadth standpoint as 1929. The second surprise was that 1969 was considerably worse than either 1966 or 1929. The third factor to note is that breadth during bear markets tends to be much more intense (on the downside) than breadth during bull market years (on the upside). However, this is logical since it is a fact that bear markets move faster and thus are generally shorter than the bull market which precedes them. For instance, the three-year 1929-32 bear market wiped out all (and more) of the gains of the whole span from 1921 to 1929. Obviously, the intensity of the 1929-32 decline was greater than the intensity of the 1921-29 rise.

At any rate, it can be seen that 1969 was a vicious bear market year by any standard. The chances of breaking even, much less making money in a year such as 1969 is almost nill. That is why I have repeated over and over again that the best policy is to stay out of stocks during the course of a primary bear market.

NOTE: I find the annual breadth figures very hard to come by. If any of my readers can supply additional figures for advances and declines I would be most appreciative.

IT TAKES MORE AND MORE: The remarks of Federal Reserve Board Chairman Arthur Burns before the Senate Banking Committee prompted this study. According to the Wall Street Journal (March 19), ".....Mr. Burns not only endorsed in general, but as a current goal, the Congressional Joint Economic Committee's recommendation that the nation's money supply be kept expanding within a 2% to 6% range of annual rates. 'This is a good, rough, general rule,' Burns replied to a question by Sen. Proxmire, which should apply 'ordinarily' although not in all circumstances."

To which I add, they're dreaming. A 2% to 6% expansion in the money supply is not going to do anything at all. The very astute Alan Abelson of Barron's ("Up and Down Wall Street," March 23) is one of the few people who is aware of the current situation, and two weeks ago he wrote, "In any event, it's well to recall that after the crunch in '66, the Fed pumped up the money supply roughly 20% in the next two years. In retrospect, '66 was kid's stuff compared with '69. What, then, would it take this time around to revive euphoria —40%? Easy money, in short, threatens to go the way of Vietnam as a bullish influence."

Mr. Abelson is not talking through his hat. During the period of 1966 to 1968 when the money supply was boosted 20%, the Gross National Product was also boosted around 20%, and it required about $1 of bank credit increase to produce each $1 increase in GNP. And that reminds me of a study by Mr. Donald Storey of the Bank Credit Analyst, a study which appeared in his October, 1969 bulletin.

Storey showed that since 1944 the receivables (money owed) to manufacturers has been climbing steadily in terms of sales. In 1944 manufacturers were owed about 80¢ for each $1 of sales. The amount owed was increased until by 1953 the figure

was $1.40 owed for each $1 of sales. By 1965 the figures touched a peak of $2.35 for each $1 of sales. In other words, this illustrates the dramatic and increasing importance of credit in manufacturers' sales over the period since 1944. Then strangely, since 1965 the ratio flattened out, even though trade credit continued to expand. This shows not only that manufacturers had to turn to other credit sources but that the picture was becoming very strained.

Storey notes that this situation is strikingly comparable to the bank credit figures as compared with Gross National Produce (i.e., the output of the entire nation). I have reproduced Mr. Storey's statistics at the right.

Note the 1921 to 1929 situation. The last column shows that during 1921-23 it required only a 33¢ increase in bank credit to produce a $1 expansion in GNP. By 1929 it required $1 for bank credit for each $1 of increased GNP. In other words, the money expansion policies of the Fed had become less and less effective as the economy becomes increasingly loaned up.

Date End of Month	Change in GNP $ Billion	Change in Bank Credit $ Billion	$ Bank Credit Change per $ GNP Change
December, 1921-December, 1923	+ 12	+ 4	$0.33
December, 1925-December, 1929	+ 13	+ 8	0.62
December, 1926-December, 1929	+ 7	+ 8	1.00
June, 1949-June, 1953	+113	+ 29	0.26
June, 1954-June, 1957	+ 82	+ 26	0.32
March, 1958-March, 1960	+ 69	+ 18	0.26
December, 1960-December, 1965	+195	+116	0.60

Now note that during 1949-53 it required only 26¢ of increased bank credit to produce a $1 expansion in GNP. But during 1960-65 it required 60¢ in bank credit to produce $1 in added GNP. During 1966-68 it required roughly $1 of bank credit to produce a $1 rise in GNP.

So we arrive at the present, at a time when I suspect that it would require more than a $1 increase in bank credit to produce each $1 rise in GNP. Indeed, if the Fed were to increase the money supply at a 2% to 6% rate, as suggested by the Joint Economic Committee, I doubt that the economy would even feel it. The current economy is at a stage where it is highly insensitive to changes in the money supply. Or to put it another way, it now requires four or five times as much inflation from the Fed as it did during 1958-60 to produce a comparable rise in GNP. The vast majority of sales-oriented economists are, in my opinion, totally unaware of the demise of the Fed as an effective instrument for pumping up the economy.

CHANGING TIMES: In 1932, if two men walked down the street, one carrying a bottle of good Scotch and the other a pocketfull of gold coins, the former would have been considered a criminal, the latter a substantial citizen. Times have changed.

On a more serious vein, I have been pondering (with the help of my brilliant wife) about the link between arms and gold. The U.S. constitution guarantees citizens the right to bear arms. Now I know that where men have guns there may be shootings and murders. But where men have lost the right to bear arms there is all too frequently a tyrannical government and a slave citizenry. Citizens of Nazi Germany and current Russia and China may not bear arms. The reason is patently obvious. Have you ever heard of a dictatorship which allows its people to have guns?

The Declaration of Independence states that it is the citizens' right and duty to throw off the yoke of a tyrannical government. Without arms, every citizen is a potential victim of a potentially unprincipled government. Regarding the danger of a "peaceful" but unarmed citizenry versus an armed but possibly rebellious citizenry, I would instantly put my trust in the latter.

A government which is unprincipled regarding monetary policy will inevitably take away its citizens' right to protect itself against those policies. The means of protection is the right to own gold. Throughout history, when citizens lost faith in paper money (i.e., the money "issued" by the government) they turned in that paper money for the only real money — gold. Any honest government will allow its people to exchange its currency for gold, since it knows that its currency is as good as gold and that its currency has the added property of drawing interest. If people prefer non-interest bearing gold to interest-bearing currency, it signifies only one thing, distrust.

Like arms, gold is a "safety-device" for the citizen. The citizen who is being robbed of his money by inflation should be able to turn in that money for gold. If the citizen is being robbed of his liberty he can take that gold and escape to another land (where his gold, being internationally acceptable), will allow him to survive. Take away the right to bear arms and the right

to hold gold and every citizen is a potential slave. A man who cannot own gold or arms cannot protect himself, his family or his savings.

DR. WILSON REPLIES: In the last Letter I included a section about debits and margins, a study which first gained real importance through the writings of Dr. Sloan Wilson of Kansas. A few days ago I received the following from Dr. Wilson. Since Sloan is undoubtedly the leading authority on stock market credit and its meaning, I wanted to include his comments in this mailing.

"Certainly mental telepathy must have prevailed. During the past few weeks I have been looking over the entire area of stock market credit analysis with the intention of writing to you. Your summary of my basic concepts is complete and concise.

"I believe we are in a primary bear market with the final third phase still in the offing. There is still much speculative money in the market and the NYSE Customers' Net Debit Balances confirm this observation. Sometime in this bear market the speculator will toss in the sponge, and when he does his margin account will decline to at least the one billion dollar level. Then he will observe a vicious decline to complete dullness at the bottom. The speculator will then be absent from the board room.

"The debit balances reached their peak of $9,790 million at the end of December, 1968. By the end of November, 1969 the balances had declined 27½%, a much greater amount than has occurred in any market correction from 1949 to 1966. Decreases in the debit balances during market corrections are examplified by a 14.0% contraction in 1957 and 10.5% in 1962. The speculator has decreased his margin from 1968 to the present by a greater amount than in any decline since the 1949 bottom formation.

"A look at the various declines of debit balances in past primary bear markets is of more than passing interest. The initial debit contraction has varied somewhat. During the first phase of the 1919-1921 bear market the margin figures decreased 24%. After a period of brief rallies and declines in the margin debit, a second vicious contraction of 28½% occurred. This latter and final margin decrease accompanied the third phase of the market decline. In the 1929-1932 bear market the initial market crash was accompanied by a decrease of 59% in the margin debt. After a surprise increase, the margin debt declined to less than the 1921 level. The initial margin debt contraction in the 1937-1942 bear market was rapid and amounted to about 50%. The margin debt increased during the "baby bulls" of 1938 and 1939 and the final decline followed.

"Why do I mention the initial margin debt contraction and the increase that accompanied the secondary rallies in bear markets? This is another form of a "bear trap" and can be a real fooler. I consider the present increase in the margin debit (debit balances) to be such a phenomenon. The loans of the large weekly reporting commercial banks for the purchase or carrying of securities are showing the same reaction, e.g., an increase with a bear market rally. It is following such periods that family fortunes are lost.

"When will we know the real bottom of a primary bear market has finally arrived? Perhaps we can rely on history repeating. The NYSE Customers' Net Debit Balances will have decreased to $1.0 billion or less. This will be confirmed by a similiar decrease in loans to brokers by large commercial banks. The volume of daily transactions of the NYSE will have decreased to where real "bottom dullness" is the note of the day. The yield on the Dow-Jones Industrials will be greater than 6.0 percent. When these criteria have been met the market place will be safe for the true investor."

STOCKS: I have included a point & figure chart of Dome Mines, a leading Canadian holding company which among other things holds a controlling interest in Campbell Red Lake and a large interest in Sigma Mines (both gold producers). (Chart courtesy of Chartcraft, Larchmont, N.Y.). With the big gold shakeout, DM fell from a 1969 high of 89 to a low that year of 43.

From that point on, while pessimism regarding gold deepened, DM began forming an important base. Between October and December, 1969, the base was completed. Over the past few months the breakout above the base occurred. In taking the "count" from the base, I am being conservative by labeling only the recent action (shown in bracket) as the base, instead of labeling the entire area since the 1969 low of 43 as the true base.

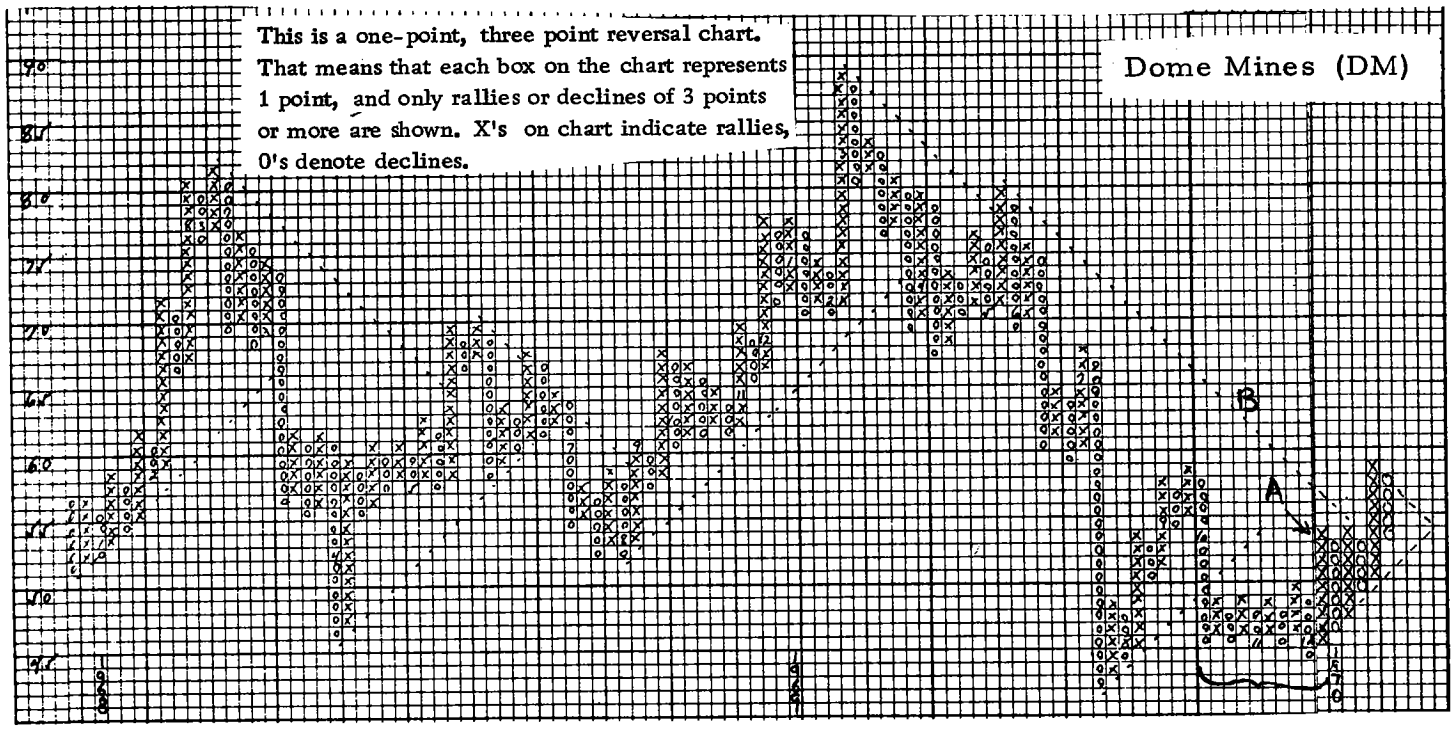
During January DM pushed above the 50 area, thus providing the first signs that a verypowerful move was in the offing. The January move on the P & F chart consumed nine vertical boxes, and this move is labeled A on the chart. On a vertical count,

the vertical row which provides the first breakout above the base gives the count. Since the rally marked A covered nine boxes, we multiply nine by three (since this is a 3-point reversal chart) and we come up with a projected rise of 27 points, to be added to the low point of the base which was 45. Thus the vertical count or projection for DM is 72.

On a horizontal count, note that there are eleven horizontal rows of boxes in the base which is the area enclosed by the bracket. Again we multiply by three giving us a count of 33 to be added on to the low point of the base which is 45. This provides a horizontal count of 78.

On the near term a move to 60 for DM would be the next important possibility, since 60 would better the late-1969 peak of 59. Because DM has now pushed through its downward or bearish trendline (marked B on chart), I feel a rally to 60 would set the stage for a further run-up into the 70's.

A particular facet of the gold picture which I now like is that no one can come up with any real news to account for the strong recent rises in the gold shares. I always like buying stocks which are acting well in the face of public apathy. My guess is that within a year the recent lows for the gold shares will seem like bargain areas.


This is a one-point, three point reversal chart. That means that each box on the chart represents 1 point, and only rallies or declines of 3 points or more are shown. X's on chart indicate rallies, 0's denote declines.
Dome Mines (DM)
B
A

Two of the outstanding performers during the 1969 collapse were Proctor and Gamble and Eastman Kodak. I have been watching these two stocks, and I was particularly interested to see their relative strength (RS) lines weaken during the last month. I have shown PG (chart courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002), and here we see the RS line breaking its upward trend during February, 1970. The same action occurred in Kodak. At a close of 104 for PG and 74 for Kodak, I would say that these two star issues have topped out. Watch for this potentially interesting action in two of the previously strongest Dow stocks.